

## Disaster Loss Examples – A Hurricane Completely Destroys a Home

### Casualty Loss Computations

Factors	Rules
Original Cost - no improvements were made	\$75,000
FMV prior to Hurricane	\$100,000
FMV after the Hurricane	\$0
Insurance coverage	50% of FMV
AGI 2004	\$60,000
AGI 2005	unknown as of November 2005

### Computation of the Adjusted Basis in a Casualty Loss

Factors	Rules
FMV before the disaster	\$100,000
FMV after the disaster	\$0
Decline in Value	\$100,000
Adjusted Basis	\$ 75,000

Subtract the insurance recovery from the lesser of decline in value and adjusted basis to determine the gain or loss -

### Computation of a Hurricane Katrina Casualty Loss versus a Regular Loss

Factors	Disaster Rules	Hurricane Katrina Rules
Adjusted Basis is smaller	\$ 75,000	\$ 75,000
Insurance	\$ 50,000	\$ 50,000
Loss	\$ 25,000	\$ 25,000
Less \$100 rule	\$ 100	N/A
Loss	\$ 24,900	\$25,000
10% limitation	\$ 6,000	N/A
Casualty Loss	\$ 18,900	\$25,000

Due to recent legislation for Hurricane Katrina, the taxpayer does not need to reduce the loss by the \$100 limitation or 10% of adjusted gross income limitation. These provisions have **not** been extended to Hurricane Rita or Hurricane Wilma, or to other Presidentially Declared Disaster Areas.

## **Casualty Gain**

All of the facts are the same as the previous example, except the taxpayer's insurance recovery is 80%, or \$80,000. The taxpayer would have a \$5000 casualty gain. They can choose to follow regular principle residence replacement rules (2-year replacement), choose special rules for Presidentially Declare Disasters (4-year replacement), or report the gain. The Hurricane Katrina special rule allows for a 5-year replacement period.

## **Casualty Creates an NOL**

All of the facts are the same as the original example, except there is no insurance recovery. If the casualty is a Hurricane Katrina loss, then the taxpayer would have a \$75,000 loss, and thus a deduction of \$75,000.

Taxpayers may elect to claim disaster area casualty losses for the year prior to the year in which the loss occurred. If a taxpayer elects to deduct the casualty loss in the prior year, then the prior year is considered the year of the loss. For Hurricane Katrina the actual loss occurred in 2005, but if claimed on a 2004 return, 2004 is considered the loss year.

If the taxpayer in the example deducts the loss for 2004, since the original Adjusted Gross Income (AGI) on the 2004 return was \$60,000, there is a potential Net Operating Loss (NOL). Assuming the taxpayer has no other items affecting the computation of the NOL, the taxpayer has an NOL of \$15,000 for 2004, which is eligible to be carried back to offset the tax liability in years prior to 2004. Further, if the \$75,000 casualty loss deduction creates a NOL for 2004, the taxpayer is entitled to a refund of the taxes he or she paid for the 2004 year.

A NOL created as a result of a casualty or theft can be carried back 3 years and then forward 20 years. Taxpayers can elect to forego the carryback on the original return and elect to only carryforward the NOL up to 20 years. To forego the carryback, the taxpayer should attach a statement to the original return by the due date, including extensions. If not elected on the original return, the election forego the NOL carryback can be made on a Form 1040X, but the Form 1040X must be filed within 6 months of the due date of the original NOL return, excluding extensions.

A NOL carryback can be filed as a Tentative Refund Request using Form 1045, which must be filed by the end of the year following the loss. Thus, if the taxpayer elects to treat the casualty loss as a 2004 loss, a Form 1045 claiming the 2004 NOL carryback must be filed by 12/31/2005. Claims for refund can also be made on a Form 1040X filed within three years of the due date of the loss-year return. Therefore, Forms 1040X for the carryback years can be filed to claim a NOL deduction for the 2004 NOL, until April 15, 2008. If the taxpayer chooses to report the loss on his or her 2005 return, then the NOL carryback, if any, can

be reported by filing Form 1045 by 12/31/06, or Form 1040X for the carryback years by 4/15/2009.